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Oil and Debt

Spot crude prices have plummeted since January as production, especially in Saudi Arabia, has risen. These lower spot prices are now pulling official prices downward. (GRAPH 1)

- We estimate the average world oil price has dropped to about \$18/barrel compared to \$27 last year; some prices have dropped below \$12.
- The expected seasonal decline in oil demand will put continued severe downward pressure on prices during the next several months, unless producers are willing to cut output, perhaps sending prices temporarily to \$10/barrel.

Saudi Arabia appears determined not to cut production and with little or no prospect for a substantial increase in demand, prices will probably continue to decline.

The decline in oil prices is generally good news for the global economy. In OECD countries, lower prices will increase growth, lower inflation, and generally decrease unemployment.

Oil importing LDCs also are benefiting substantially from oil price declines.

- In addition to lower oil costs, many countries' debt-servicing costs are declining because of drops in interest rates.
- Higher OECD economic growth should also boost export earnings.
- Big debtors Brazil and South Korea will net nearly \$2 billion each in savings on interest and oil costs, and in increased exports.

For oil exporting debtors, however, the picture is much different.

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- Hardest hit are Mexico, Nigeria, and Venezuela.
- Depending on how far prices fall, Mexican revenues could be $3-$5 billion less than initially estimated for 1986, a major blow when debt payments due this year are roughly $13.5 billion, including $10 billion in interest.
- Nigeria and Venezuela will suffer similar losses.
- Algeria, Egypt, and Indonesia could be pushed into the troubled debtor category because of their dependence on oil revenues.

Oil exporting debtors will be forced to draw down foreign exchange reserves, cut imports and seek new loans. Bankers will be reluctant to lend given these countries' deteriorating ability to pay back what they already owe.

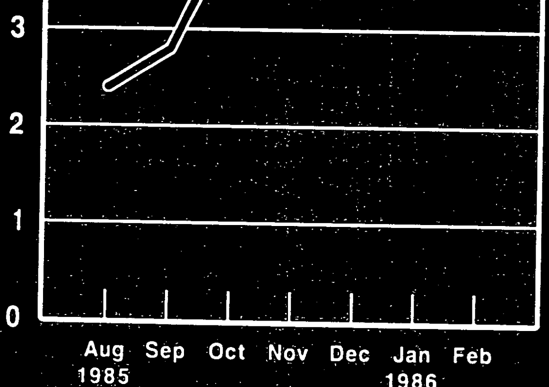
We are particularly concerned that reduced oil revenues and the need for further economic austerity could prompt serious political unrest or a major policy shift in debtor countries like Mexico and Egypt. (GRAPH 2)

- In Mexico we see the potential for a suspension of debt payments if it is unable to reach an accommodation with creditors on debt relief and if political pressures from populists in the ruling party mount.
- In Egypt, riots two week ago are indicative of the kind of unrest that could erupt if the government pursues an IMF-supported austerity program.

Even in the absence of significant unrest, the financial fallout from lower oil prices will strain our relations with some Third World allies who will be seeking relief from US banks as well as the government.

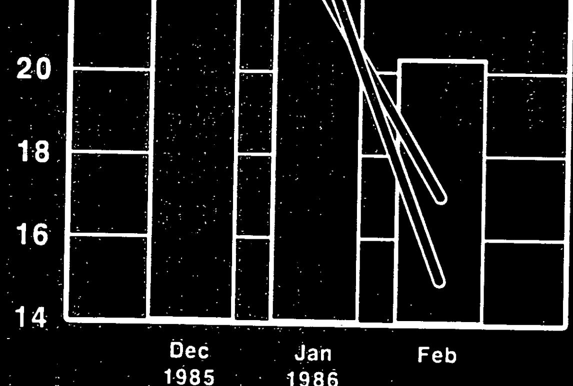
Saudi Oil Production and Average World Oil Prices

Saudi Oil Production*



*Includes Neutral Zone production.

Average World Oil Prices



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LDC Net Oil Exporters:

Concern That Reduced Oil Revenues in 1986 Will Prompt Serious Political Unrest or a Major Policy Shift*

	Latin America	Near East	Africa / Far East
High		Egypt Iran Libya	Nigeria
Medium	Mexico Peru Ecuador	Tunisia Iraq	Malaysia
Low	Venezuela	Algeria Saudi Arabia Kuwait UAE Qatar Oman Bahrain	Indonesia Angola Cameroon

[redacted]

*Assumes 1986 average oil price of $20 per barrel.

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